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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the matter of:

Telephone Number Portability

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CC Docket No. 95-116
RM 8535

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**COMMENTS OF AIRTOUCH COMMUNICATIONS, INC. IN RESPONSE TO
FURTHER NOTICE OF PROPOSED RULEMAKING**

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AirTouch Communications, Inc. ("AirTouch") hereby submits its comments regarding the Commission's Further Notice of Proposed Rulemaking ("Further Notice") in the above-captioned proceeding.

Summary of Position

The Commission has correctly identified the key criteria for determining a competitively neutral methodology for allocating shared number portability costs, but it has erroneously concluded that an allocation based upon gross revenues less payments to other carriers satisfies those criteria. Any allocation based upon unadjusted or adjusted gross revenues will have different effects upon carriers with different cost structures and thus fails the test of competitive neutrality. An allocation based upon total profits would come as close to competitive neutrality as possible using a financial measure as the basis for allocation, but even such an approach would fail the second criterion because the telecommunications market is not fully competitive.

In addition, an allocation methodology based upon any financial measure would face significant practical problems because of the need to determine the relevant revenues or profits. The difficulty of separating revenues or profits from domestic telecommunications revenues from those derived from other operations would be compounded by the need to identify the revenues

or profits associated with each number portability region. Such revenues and profits can be unreliable because they are also subject to artificial manipulation and timing issues.

An allocation based upon carriers' total access or presubscribed lines would fail the second competitive neutrality criterion because it would have differing effects on carriers depending upon whether they serve predominantly high volume or low volume customers.

The only basis for allocating shared number portability costs that is competitively neutral is using each carrier's total retail minutes of use. Such an approach would satisfy both of the Commission's criteria, and the failure of any other methodology to do so justifies the somewhat greater complexity of using minutes of use.

1. An Allocation of Number Portability Costs on the Basis of Revenues or Profits Would Not Be Competitively Neutral.

In Section 251(e)(2), Congress directed the Commission to determine a competitively neutral basis for allocating the costs of establishing number portability among all telecommunications carriers. In the Further Notice, the Commission proposes to use two criteria to judge whether an allocation methodology is competitively neutral and tentatively concludes that an allocation of number portability costs based upon carriers' gross revenues minus payments to other carriers would satisfy these criteria. Although the Commission has correctly identified the key criteria for determining competitive neutrality, its tentative conclusion that an allocation based upon gross revenues (whether adjusted or unadjusted) would be competitively neutral is fundamentally flawed, as any such allocation would violate both of the Commission's criteria. Moreover, an allocation based upon profits would violate the second criterion.

The Commission's first criterion for competitive neutrality is that an allocation methodology "should not give one service provider an appreciable, incremental cost advantage

over another service provider, when competing for a specific subscriber." Further Notice at 109, ¶ 210. Any measure of financial performance would potentially violate this criterion because carriers vary considerably in the gross revenues or profits they derive from a given customer. While this variance may itself make it more or less difficult for one carrier or another to attract a given customer, the use of gross revenues (whether adjusted or unadjusted) or profits (whether economic profits, total profits, or accounting profits) to allocate shared number portability costs would exacerbate such disparities. A carrier with higher revenues or profits per customer or per unit of service may nonetheless be able to attract customers because of superior service or more effective marketing compared to a carrier with lower revenues or profits per customer. Yet if revenues or profits were used to allocate shared number portability costs, the former carrier would incur a greater incremental number portability expense than the latter when competing for the same customer. In at least some cases, the difference could be enough to discourage competition between such carriers.

The Commission's second criterion for competitive neutrality is that the selected allocation approach "should not have a disparate effect on the ability of competing service providers to earn a normal return." Further Notice at 109, ¶ 210. An allocation based upon either unadjusted or adjusted gross revenues would violate this criterion as well. An allocation based upon unadjusted gross revenues would not be competitively neutral unless all relevant carriers have similar cost structures. Consider the hypothetical case of two carriers having identical gross revenues: a facilities-based carrier and a pure reseller. The former carrier has very high capital costs and low operating costs, while the latter has almost no capital costs and very high operating costs. Assuming that each carrier is earning a "normal" return on its

investment before number portability funding, the former's earnings are much "higher" than the latter's because of the greater investment upon which it earns a return. Yet if each carrier is allocated the same amount of number portability cost, the resulting expense has radically different effects on the carriers' ability to earn a "normal return."

At footnote 609 of the Further Notice, the Commission cites David N. Hyman, *Public Finance: A Contemporary Application of Theory to Policy*, 474-76 (2d Ed., The Dryden Press 1987) as the sole support for the tentative conclusion that a cost allocation based upon gross revenues is the "second best alternative" to being competitively neutral. The cited material contains no discussion of gross revenue-based allocation models, however, and it in fact supports the conclusion that such an allocation approach is *not* competitively neutral if, as is true in the telecommunications industry, there are significant differences in cost structures among firms or industry segments.

In the cited portion of Hyman's book, the author first examines the effect on price and output of a hypothetical tax on economic profits—profits in excess of a normal return on investment that, by definition, are not sustainable in a fully competitive market. Hyman demonstrates that a tax on economic profits does not create incentives to increase price or reduce output. In that sense, then, such a tax would be competitively neutral.¹ Hyman then demonstrates that in the short run a tax on total profits (*i.e.*, normal return on investment plus any economic profit) similarly does not affect price or output, although it does so in the long run by creating an incentive to move investment in order to reduce or avoid the incidence of the

¹ Hyman notes, however, that because economic profits by definition are not sustainable in a competitive market, a tax on economic profits is not a reliable source of funding.

tax. The author nowhere uses the term "competitively neutral," nor is the discussion concerned with inter-firm effects.

The cited material does not discuss the effect of a tax on gross revenues. Because the relationship between gross revenues and normal return is highly dependent upon a firm's cost structure, the fact that a tax on total profits (including the total profits of firms earning only a normal return) is competitively neutral in the short run strongly suggests that a tax on gross revenues is not competitively neutral in the absence of a consistent cost structure across firms. Reducing a firm's total profits by a uniform percentage of gross revenues has a dramatically different impact on returns on investment for capital-intensive versus operating cost-intensive firms. This clearly is not competitively neutral, and this is so whether the latter firm's high operating costs represent payments to other carriers or other operating costs.

The Commission has proposed to adjust gross revenues by subtracting payments to other carriers in order to avoid a "double count" of the same revenue dollars. Further Notice at ¶ 213; *see also Assessment and Collection of Regulatory Fees for Fiscal Year 1995, Price Cap Treatment of Regulatory Fees Imposed by Section 9 of the Act*, Report and Order, 10 FCC Rcd. 13512, 13558-59 (1995). An allocation based upon gross revenues minus payments to other carriers would produce dramatically different results from an allocation based upon unadjusted gross revenues. It would ameliorate somewhat the disparate treatment of facilities-based carriers and resellers. However, carriers with high capital costs and carriers with high operating costs that do not consist primarily of payments to other carriers would be unduly penalized and less able to compete effectively.

Similarly, a cost allocation based upon total profits would be fundamentally flawed because of the difficulty in determining profits. Although accounting profits may closely approximate total profits in the long run, differences in depreciation schedules and methodologies and other timing-related differences between firms make short run comparisons of accounting profits highly problematic. Moreover, not all firms, even successful ones, are profitable at any given time. New entrants may often operate for protracted periods without earning an accounting profit while they build market share and amortize startup costs. In the future, many incumbents may go through periods without accounting profits as they retrench and reposition themselves in the newly competitive telecommunications market. Allocating no shared number portability costs to carriers in such situations would be highly unfair because of the substantial benefits they receive from number portability.

The use of any financial measure to allocate shared number portability costs presents significant practical problems because of the need to identify the relevant revenues. Although it is relatively simple to determine the gross revenues of a purely domestic carrier that is not engaged in any other line of business, to an increasing extent that is not the typical carrier. Many carriers have international operations, and most have interests in other businesses. Complex accounting rules would be required in order to separate a firm's domestic telecommunications service revenues from its other revenues and to prevent carriers from shifting revenues and costs between services and associated equipment.

To the extent that number portability costs are to be shared on a regional, rather than nationwide basis, the difficulty of determining relevant revenues, costs and profits would be compounded even more for those firms operating in more than one region. However, because

different regional databases are likely to have different costs due to differences in wage rates, management styles, scale economies and other factors, competitive neutrality requires that those carriers within a region should bear only those common regional number portability costs. The requirement of competitive neutrality does not justify requiring carriers in relatively low cost regions to subsidize those in higher cost regions.

To summarize, the use of gross revenues, either unadjusted or adjusted, as the basis for allocating shared number portability costs would not be competitively neutral. The use of unadjusted gross revenues, while perhaps competitively neutral within industry segments having common cost structures, would unduly and improperly favor industry segments with higher capital costs and operating margins. The use of gross revenues minus either payments to other carriers or receipts from other carriers would unfairly favor different industry segments. Total profits should not be used as the basis for allocation because of significant practical problems associated with determining those profits from the relevant domestic telecommunications that are produced by multiproduct and multinational enterprises, as well as the problems created by imperfect competition in the telecommunications market. The use of any of these measures to allocate number portability costs would affect investment decisions and would not be competitively neutral.

II. Number Portability Costs Should Be Allocated on the Basis of Total Retail Minutes of Use.

Total retail minutes of use provide the only truly competitively neutral basis for allocating the shared costs of number portability. Only an allocation based upon total retail minutes of use would satisfy both of the Commission's criteria for competitive neutrality. Each minute of use of a carrier's service by a consumer provides the carrier a revenue opportunity, whether or not

the carrier prices the particular service on a per-minute basis. An allocation of number portability costs on the basis of retail minutes of use would satisfy the Commission's first criterion for competitive neutrality. When a customer changes carriers, the resulting number portability cost incurred by the new carrier would exactly equal the number portability cost avoided by the old carrier, regardless of whether either, neither, or both carriers served the customer through a ported number. This is the essence of competitive neutrality. Such an allocation would also satisfy the Commission's second criterion. Since each minute of use provides a revenue opportunity, the returns of carriers with greater returns per minute of use would be reduced by the same percentage as those of carriers with lower returns per minute of use, whether the difference in rates of return resulted from differences in cost structure or other factors.

In Assessment and Collection of Regulatory Fees for Fiscal Year 1995, Price Cap Treatment of Regulatory Fees Imposed by Section 9 of the Act, Report and Order, 10 FCC Red. 13512, 13556-57 (1995), the Commission noted that some services, such as special access services, often are not measured on a minutes of use basis and that an allocation methodology based upon minutes of use therefore must rely upon network usage assumptions to the extent that actual minutes of use are not measured. The Commission concluded that the "calculation problems" associated with minutes of use supported its decision to assess regulatory fees on the basis of gross revenues. When assessing regulatory fees, however, the Commission had not been expressly directed by Congress to do so on a competitively neutral basis. Further, while the Commission concluded—erroneously—that the use of gross revenues minus payments to other carriers would be a competitively neutral way of allocating the fees it must collect from IXCs,

LECs, CAPs and pay phone providers, it made no effort in that case to allocate fees across industry segments in a competitively neutral manner and used significantly different methodologies to allocate regulatory fees within different industry segments. In the case of number portability costs, the specific Congressional directive mandating competitive neutrality and the need to use a common allocation methodology for all industry sectors certainly justifies using a minutes of use-based allocation methodology.

Although an allocation based upon retail minutes of use fully satisfies both competitive neutrality criteria, the Commission has expressed concern with the need to rely upon network usage assumptions in order to include minutes of use that are not currently measured. An allocation based upon each carrier's total access or presubscribed lines would be somewhat simpler to administer and would satisfy the Commission's first criterion because, like an allocation based upon minutes of use, it would result in the same incremental number portability cost for any carrier to serve a given customer. Such an approach would not, however, satisfy the Commission's second criterion.

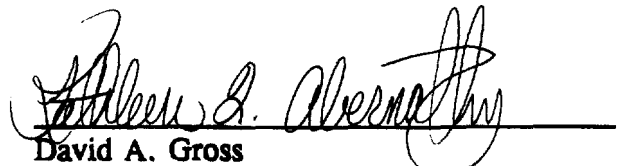
The problem with allocating shared number portability costs on the basis of access or presubscribed lines is that all customers are not equally valuable. In general, a high volume customer is more valuable to a carrier than a low volume customer. Allocating shared number portability costs on the basis of access/presubscribed lines would allocate the same share of such costs to a carrier whether it served predominantly high or low usage customers. Because a carrier serving predominantly high usage customers generally earns a higher return per customer than one serving predominantly low usage customers, an allocation based upon access/presubscribed lines would affect differently the returns of carriers serving predominantly high

usage versus low usage customers. This would marginally discourage carriers from marketing their services to low usage customers and, to that extent, would mean less competition for such customers. For full competitive neutrality, the number portability cost allocation methodology should not only place carriers on an equal footing (from the standpoint of shared number portability costs) in competing for the same customer; it should also place them on the same footing in competing for the same amount of usage, or potential revenue.

Conclusion

For the foregoing reasons, the Commission should allocate shared number portability costs on the basis of each carrier's total retail minutes of use. This is the only allocation methodology that satisfies both of the Commission's competitive neutrality criteria, imposing the same shared number portability cost per unit of revenue opportunity and the same incremental number portability-related cost for each carrier competing for a customer.

Respectfully submitted,



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